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Rise of Complementarity between Global and Regional Financial Institutions: Perspectives from Asia¹

In Global Policy, 2018

Pradumna B. Rana, S. Rajaratnam School of International Studies & Ramon Pacheco Pardo, King's College London

Abstract

Global economic governance is in flux. The institutions and norms set up by the US and other Western powers decades ago are being eroded. Regional organisations and emerging powers are challenging them. This is especially the case in East Asia and China. Or are they? In this article we argue that East Asian countries in general and China in particular are not challenging existing global institutions and norms. Instead, they are setting up and developing institutions that complement – rather than compete against – existing institutions. Even though there is a degree of “healthy” competition between regional institutions and their global counterparts, the former are essentially complementary to the latter. Global institutions can offer knowledge and capacity building to regional institutions, which in turn can provide access to a larger pool of resources. To prove our argument, we analyse the cases of liquidity provision – in the form of the IMF and the Chiang Mai Initiative Multilateralisation – and development financing – with the World Bank on the one hand and the Asian Infrastructure Investment Bank and the New Development Bank on the other. Our findings suggest that the multi-layering of international governance need not lead to competition between layers.

Keywords

Finance, liquidity provision, development financing, East Asia, China

Global economic governance is in flux. The institutions and norms set up by the US and other Western powers (such as the IMF, WTO, and the World Bank) are being eroded. The economic rise of emerging countries, their newfound diplomatic assertiveness, and contestation of supposedly universal norms are driving a process whereby the organisations launched during the post-World War II period are being challenged by regional organisations and emerging power-led initiatives – especially in East Asia and from China. Or are they?

This article will argue that there is clear potential for and evidence of cooperation and “healthy” competition between East Asian regional organisations and China-led governance initiatives on the one hand and existing global institutions on the other. There is less evidence of “unhealthy” competition such as the race to the bottom and forum shopping. The article will underpin its normative case for cooperation and “healthy” competition by applying existing theoretical research on the fragmentation of global governance, as well as by presenting empirical evidence of existing cooperative efforts. Nonetheless, the article will argue that there are limits for potential cooperation and “healthy” competition between regional and global institutions. These are the history of the establishment of regional institutions, the gap between rhetoric and reality, and the evolving geopolitical forces.

The question of whether East Asian regional institutions in general and China in particular will seek to cooperate with or compete against international institutions is crucial for the future of global economic governance. As Chin and Freeman (2016) posit, the rise of an increasing number of emerging powers has resulted in the contestation of international institution priorities, agenda setting, norms, rules and principles. Furthermore, the development of multi-layered governance – mixing global, regional, bilateral and national arrangements – has been portrayed as a defection from global institutions (Cooper et al., 2008).

The case of East Asian regional institutions and China-led institutions merits particular attention. Outside of the EU, East Asia is the part of the world where regionalism is strongest. Economic and financial initiatives such as the Chiang Mai Initiative Multilateralisation (CMIM), the ASEAN+3 Macroeconomic Research Office (AMRO) or the pan-continental Asian Development Bank (ADB) form an institutional network linking together the countries in the region. Moreover, the CMIM, AMRO and other financial initiatives such as the Asian Bond Markets Initiative (ABMI) were the direct result of the Asian financial crisis (AFC) and displeasure with the behaviour of the IMF (Pacheco Pardo and Rana, 2015). Thus, they are useful case studies.

China, meanwhile, has been portrayed as the strongest disruptor to the existing global governance architecture (Beeson and Li, 2016). Beijing has made no secret of its unhappiness with existing global institutions – especially the limited power that China holds, as well as their allegedly pro-Western agenda (Beeson and Li, 2016). Furthermore, Chinese authorities have been busy launching potentially alternative institutions. Amongst them, the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank (NDB) stand out. As with the East Asian financial institutions highlighted above, these two economic institutions are largely the result of discontent with existing Western-led organisations (Wang 2015). Given that the key reason why Beijing has launched these institutions is similar to that of East Asian financial initiatives, it is of analytical interest to understand China’s potential behaviour towards global institutions in parallel with the approach that regional institutions have taken. This is what we do in this article.

To make our case that the East Asian regional layer and China-led institutions have a clear potential to work in cooperation with the global layer while injecting a dose of “healthy” competition, but that there are limits to this cooperation, we focus on the global financial architecture (GFA) defined as the financial safety net and development finance architectures. The reasons are two-fold. First, financial safety net is an area in which East Asian countries have established institutions whose membership includes countries in the region alone – thus preventing the US from exercising power from the inside. Meanwhile, development finance is an area in which China has taken a decisive lead role and the US and Japan are not part of its recently-launched institutions. Thus, we can observe the approach towards global institutions that East Asia and China have taken when independent from direct American – and, in the latter case, Japanese – influence. Second, as already explained, in both of these areas institution-building resulted from displeasure with existing global arrangements. In theory, this would make full-blown “unhealthy” competition more plausible.²

In the following section we will present the theoretical framework underpinning our analysis, as well as a short summary of our methodology. We will then briefly examine factors that have led to the decentralisation and fragmentation of the GFA. This will be followed by an exploration of the emerging multi-layered financial safety net in East Asia. We will then suggest how the East Asian regional layer might cooperate with its global counterpart, and the limits to any potential cooperation and “healthy” competition. This will be followed by a section analysing the decentralising global development finance architecture and China’s institutional build-up in this area. We will then analyse the extent to which China-led institutions might cooperate with their global counterparts, as well as, the limits to cooperation and “healthy” competition. A concluding section will briefly summarise our arguments and findings.

Theoretical Framework and Methodology

The growth of regionalism in terms of both the number and scope of regional institutions, together with the increasing assertiveness of emerging powers willing to launch and participate in new institutions, has led to discussions about the so-called ‘contested multilateralism’. This term defines the idea that powers dissatisfied with status quo institutions seek to create their own that may challenge the rules and practices of the status quo institution (Morse and Keohane, 2014). Contested multilateralism can take two forms: (1) regime shifting, which occurs when dissatisfied powers shift to an alternative institution that they find more favourable (e.g., the World Bank entering the field of global health governance), and (2) competitive regime creation, which occurs when dissatisfied powers create a new formal institution or informal arrangement (e.g., Proliferation Security Initiative) (Morse and Keohane, 2014). The latter is the case in regional financial and development finance architecture in East Asia and China-led initiatives, respectively.

The creation of alternative institutions has led to the fragmentation of global governance in multiple areas. Fragmentation refers to the institutional framework in a given policy domain including a patchwork of international institutions with different characters, constituencies, spatial scope and subject matter (Biermann et al., 2009). A priori, fragmentation seems to have negative connotations because it can lead to exclusion and forum shopping (Zurn and Faude, 2013). However, fragmentation is not necessarily negative when we understand that fragmentation partially results from functional differentiation linked to the increasing complexity of policy domains, and is not merely the consequence of a powerful actor being dissatisfied with existing institutions (Zurn and Faude, 2013). This suggests that contested

multilateralism is not necessarily related to contestation per se only, but rather can also result from functional needs.

Fragmented global governance and cooperation among institutions are therefore not mutually exclusive. Functional overlap can lead to cooperation resultant from a division of labour among institutions, in turn linked to the members of a particular institution having an interest in a particular division of labour. This fosters institutional adaptation to achieve the desired complementarities (Gehring and Faude, 2014). Instead of turning to forum shopping, as much current literature assumes, members of two or more institutions with functional overlap will seek to maximize their participation in multiple institutions. They do so by pressing for adaptation and concomitant division of labour, as the case of agricultural GMOs illustrates (Gehring and Faude, 2014).

In the finance architecture, however, existing literature suggests that fragmentation seems to be leading to competition. Regional financial institutions in the EU, East Asia, Latin America or among the BRICS stem from a displeasure with the IMF. The open and significant differences between EU institutions and the IMF in areas such as the division of labour or debt restructuring, among others, point in this direction (Henning, 2017). In the development finance architecture also existing literature suggests that fragmentation is resulting in competition. The AIIB and the NDB are portrayed as focused on the narrower needs of their members and willing to disregard existing conditionality and norms (Kahler, 2017).

We disagree with these negative views. Building on the ‘functional fragmentation’ literature just discussed, we will explain how a division of labour is emerging and is likely to continue to develop between East Asian or China-led institutions on the one hand and global institutions on the other. We will show how this has already resulted in incipient institutional adaptation and cooperation. We will argue, however, that cooperation has not entirely eliminated existing limits to cooperation due to geopolitics and a history of limited cooperation across East Asia.

To prove our argument, we use three research methods. First, we conduct desk research to explain and analyse the creation and development of multi-layered governance architectures in the areas of finance and development finance. Second, we use content analysis of official documents from global and regional institutions to analyse the extent to which cooperation and “healthy” competition will, in our view, define the relationship between global and regional institutions, as well as the limits to said cooperation. We should note that we have also used some desk research for the cooperation and limits analysis, as well as some content analysis for the creation and development of multi-layered architectures sections. Third, we interviewed staff from international institutions and government officials for background purposes, and in some cases to clarify and support specific arguments.

Decentralising Global Financial Architecture

As Kindleberger (1986) has noted, the absence of a rules-based system contributed to the economic instability during the inter-war period that eventually led to the Great Depression of the early 1930s. Thus, the focus of the Bretton Woods conference in 1944 was to establish a set of rules-based global institutions to provide public goods. In the area of finance, the IMF was established to provide short-term finance for macroeconomic stability, and the World Bank was established to provide long-term development finance for poverty reduction.

This GFA worked well for a number of decades and brought about economic prosperity across different parts of the world. More recently, however, it has tended to (1) decentralise and become more fragmented and multi-layered with global, regional, bilateral and national economic institutions, and (2) move away from a rules-based to a more informal network-based system (Rana, 2014).

A number of factors account for the evolution of a more decentralised and fragmented GFA. Firstly, there has been a shift from a uni-polar to a multi-polar world, especially the rise of China and its demand and desire to play a greater role in writing global rules and provide financial resources. Secondly, there have been impediments to the effective reform of the governance of global institutions to give a greater voice to emerging powers. Global institutions are relatively inflexible institutions and cannot change even if they wish to. These two factors relate to the idea that global governance fragmentation is partly related to powerful actors being dissatisfied with existing institutions and unwilling to support them. Kawai et al. (2009) have applied the theory of clubs to explain this phenomenon. Thirdly, financial globalisation has dramatically changed the environment in which global institutions operate and has also reduced their effectiveness, which is linked to the notion that functionality is a driver behind fragmentation. Kawai and Rana (2009) have argued that preventing and managing a financial crisis in a globalised world needs actions at the global, regional, and national levels.

Looking forward, the decentralization and fragmentation of the GFA could accelerate further under the Trump Presidency. The US has for a long time played a lead role in international economic institutions through formal means (e.g., financial contributions) and informal practices and conventions (Foot, MacFarlane, and Mastanduno, 2003). But President Trump's preference for "fair trade" and "bilateralism" could mean reduced US support and commitments for multilateral bodies such as the IMF, the World Bank, and the WTO. At the same time, the BRICS, and China in particular, have expressed interest in filling the gap (Haas, 2017). Nonetheless, China's support for multilateral institutions has not meant an end to its efforts to develop alternative ones.

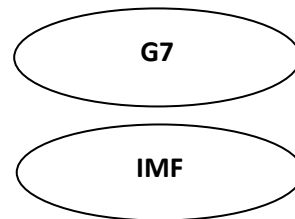
The decentralisation and fragmentation of the GFA would suggest that global and regional institutions compete against each other. Authors focusing on a competitive relationship argue that regional institutions will make their global counterparts obsolete and create opportunities for arbitrage (Rhee et al., 2013; Henning, 2017). This notwithstanding, a complementary relationship between the two sets of institutions seems to be emerging for a number of reasons. First, both regional and global institutions have relative comparative advantages in different areas – cross-regional expertise and experience plus institutional memory in the case of the latter, region-specific knowledge and proximity in the former (Kawai and Rana, 2009). Second, the demand for international public goods is big enough for both to co-exist (Desai and Vreeland, 2011). Third, the still-limited capacity of regional institutions needs improving – which global institutions can help with (Desai and Vreeland, 2011). Fourthly, managing globalisation needs global, regional, and even national institutions (Kawai and Rana, 2009). These intertwined reasons are at play in the cases of financial safety nets and development finance.

Multi-layered Financial Safety Net Architecture

Initially, the international financial safety net architecture was centralised and included global institutions only. The architecture which prevailed in the 1970s and 1980s is depicted in

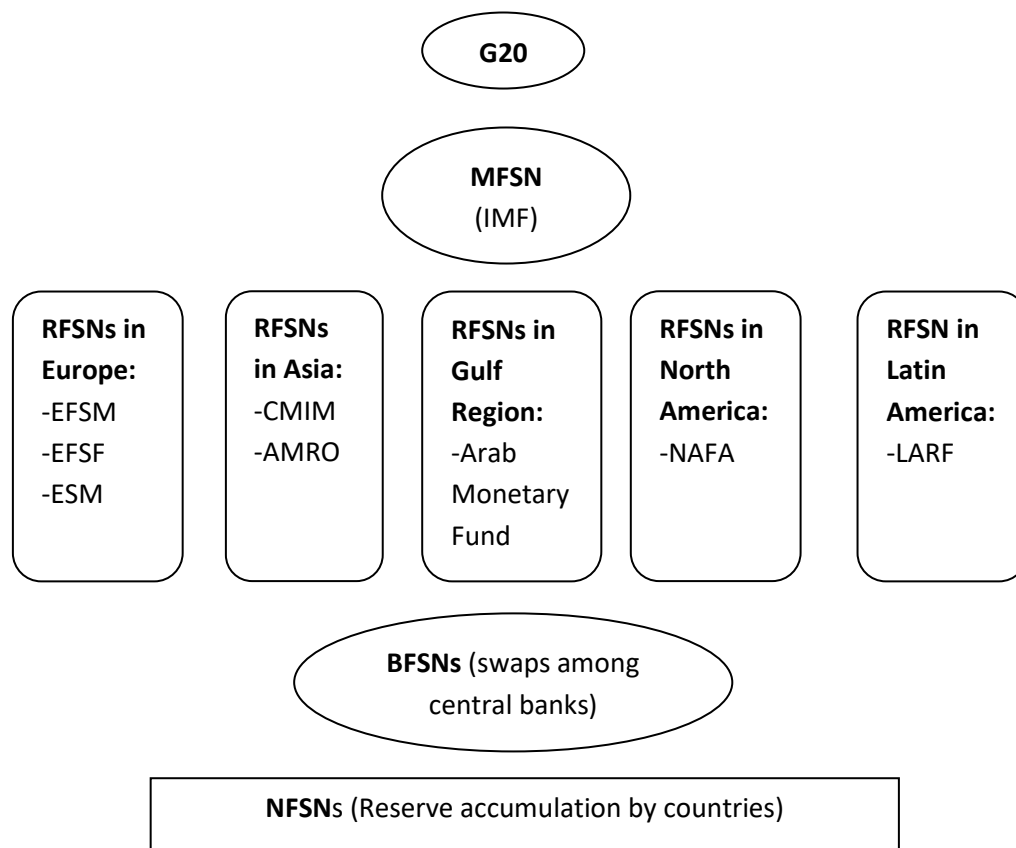
Figure 1. It comprised the IMF with the G7 as the oversight body. This architecture was mostly successful in promoting macroeconomic and financial stability, aside from the Latin American debt crisis of the 1980s and the problems with the European Monetary System in the early 1990s.

Figure 1. Centralised financial safety net architecture



In the aftermath of the AFC and the GFC, however, this centralised financial safety net architecture has become more decentralised – accelerating a trend that in some regions had already started before. The decentralising Global Financial Safety Net (GFSN) comprises the Multilateral Financial Safety Net (IMF), Regional Financial Safety Nets (such as the CMIM and AMRO in East Asia), Bilateral Safety Nets (swaps among central banks), and National Financial Safety Nets (reserve accumulation by countries), as depicted in figure 2.

Figure 2. Decentralised financial safety net architecture



Notes: AMRO = ASEAN+3 Macroeconomic Research Office; BFSN = Bilateral Financial Safety Nets; CMIM = Chiang Mai Initiative Multilateralisation; EFSF = European Financial Stability

Facility; EFSM = European Financial Stabilisation Mechanism; ESM = European Stability Mechanism

ASEAN+3 RFSN and the IMF

Before the AFC, the only RFSN in East Asia was the ASEAN swap arrangement (ASA), which was established in 1977 when the original members agreed to a reciprocal currency swap arrangement among themselves. The idea was to provide liquidity support to members experiencing balance of payments difficulties. The maximum amount of liquidity available under the ASA eventually reached \$200 million. The size of the ASA was too small to be of use in helping countries manage the AFC though; thus, it was not used.

The AFC led East Asian countries to revisit the issue of a RFSN, mainly because of the way in which the IMF managed the crisis. Four of the crisis-affected countries – Indonesia, Philippines, South Korea and Thailand – had accepted an IMF programme, while Malaysia went alone. The IMF misdiagnosed the problem and prescribed the wrong medicine (Sussangkarn, 2010). It was also believed at the time that the IMF might not have adequate resources to help countries manage a “capital account” crisis associated with large inflows and sudden reversals of private capital flows (Kawai and Rana, 2009).

There was a strong feeling among policymakers in East Asia that a regional financing facility could act as the first line of defence. It could provide short-term liquidity and thereby prevent a crisis in case of speculative attacks (Sussangkarn, 2010). As a result, ASEAN+3 finance ministers agreed in May 2000 to launch the Chiang Mai Initiative (CMI) as a regional “self-help and support mechanism” to provide “sufficient and timely financial support to ensure financial stability in the East Asia region” (ASEAN+3 Finance Ministers, 2000). The CMI expanded the ASA to all ASEAN members. In addition, it set up a bilateral swap network among the ASEAN+3 countries. The ASA was expanded to eventually reach \$2 billion. ASEAN+3 countries also signed bilateral swaps among each other and by 2008 there were 16 agreements amounting to \$84 billion (Pacheco Pardo and Rana, 2015).

Pursuit of complementarity and – as a result – cooperation has been the key focus of the ASEAN+3 RFSN. From the beginning, ASEAN+3 Finance Ministers stipulated that the RFSN in East Asia should “supplement the existing international facilities” (ASEAN+3 Finance Ministers, 2000). The way that complementarity was promoted in the CMIM – and its predecessor, the CMI – was by requiring the existence of an IMF-supported program to provide assistance in excess of a certain percentage of maximum access. Initially, only ten per cent of the maximum access was readily available with 90 percent linked to an IMF programme. The size of the delinked portion was subsequently increased. The link to the IMF was also intended to address the moral hazard problem in lending and the lack of independent surveillance capacity in the CMI (Pacheco Pardo and Rana, 2015).

In the aftermath of the severe credit crunch that the region experienced because of the GFC in 2008, the CMI bilateral swaps were not used. This was because of the small size of the swaps and the absence of a rapid response mechanism to trigger the swaps – each bilateral swap had to be triggered one at a time (Pacheco Pardo and Rana, 2015). Leaving technical issues aside, CMI swaps were not used due to the rhetoric-reality gap in East Asia as well. This gap refers to the fact that the rhetoric of economic cooperation in the region is not always matched by its reality in practice (Jones and Smith, 2007).

Since the GFC, ASEAN+3 has taken a number of actions to increase financial resources available from its RFSN and to clarify the disbursement procedures. These include doubling the size of the CMIM, increasing the delinked portion to 30 per cent, and agreeing to the decision-making process and operational guidelines. AMRO also now has the status of an international organisation (Chang, 2016). Are these actions sufficient to ensure that the CMIM will be utilised when the region faces the next crisis? Probably not.

Under the new agreement, five ASEAN members – Indonesia, Malaysia, Philippines, Singapore, and Thailand – can borrow a maximum amount of approximately \$23 billion each from the CMIM with an IMF programme in place – one-third of which will be the delinked portion – under a single contract at one go (Hill and Menon 2014). These amounts are large compared to the old CMI swaps, but still inadequate to prevent and manage the newer types of capital account crisis associated with large inflows and sudden withdrawal of short-term financial capital. It is unlikely that ASEAN+3 countries will increase their commitments to the CMIM and raise the percentage of the delinked portion without the capacity of AMRO being strengthened significantly for regional surveillance and for designing conditions under which funds can be loaned out – otherwise there could be moral hazard.³ Although AMRO has come a long way, as a relatively new institution it still lacks the research capacity, human resources, and experience to serve as an independent surveillance unit.

More important is the speed and efficiency with which requests for assistance can be disbursed (Hill and Menon 2014). The operational guidelines for the CMIM note that a decision based on two-thirds majority are to be made within two weeks of the swap request (AMRO, 2012). This is unlikely to happen as the CMIM is not a centralised fund, but a “self-managed” arrangement where contributions are held by individual central banks and monetary authorities. Also, the decision rests with a non-resident body and there is uncertainty regarding the nature of information and the analysis required to facilitate the decision-making (Sussangkarn, 2010). In contrast, bilateral swaps are fast-disbursing and come without explicit conditionalities as they are well-collateralised.

The inadequacies of the CMIM can also be attributed to the just-mentioned rhetoric-reality gap, which means that countries in the region do not match their verbal commitments to cooperation with actual actions. It can also be attributed to geopolitical competition between China and Japan. Getting both of them to agree to their respective financial contributions and a fair distribution of voting ratios already proved difficult (Pitakdumrongkit, 2015). Furthermore, both powers seem to now be engaging in competitive bilateral swap arrangement network building through their central banks (Pacheco Pardo, 2017). These inadequacies, however, are not necessarily an impediment to cooperation with the IMF.

ASEAN+3 RFSN and Pursuit of Complementarity and “Healthy” Competition with IMF

Since the present modality of cooperation between the ASEAN+3 RFSN and IMF is ill-defined, a more structured form of cooperation between the two institutions could be considered. This framework would involve pooling of financial, human, and technical resources between the ASEAN+3 RFSN and IMF in three cooperative activities (Table 1). Given the degree of functional overlap between the RFSN and the IMF, resource pooling would allow East Asian states to maximize the benefits of both safety nets by forcing institutional adaptation, especially at the ASEAN+3 level which they control.

Table 1: Structured ASEAN+3 RFSN and IMF Cooperation

Possible issue/area of cooperation	Advantages
CRISIS MANAGEMENT 1. Simultaneous request for financial assistance from CMIM and IMF and joint analysis and evaluation	-Bring in expertise from outside East Asia to supplement AMRO resources -IMF staff, in theory, would be more dispassionate to regional countries
2. Joint monitoring and surveillance, joint AMRO-IMF missions, and jointly-developed conditionality	-Focus on relative comparative advantages (IMF, macro and macro financial and cross regional experience; AMRO, regional financial and capital market developments, and structural reforms)
3. Co-financing (with amounts depending on specific basis) and joint supervision	-Would leverage CMIM funds as IMF funds would also come in
CRISIS PREVENTION 4. Joint assessment (of eligibility) and co-financing	-Focus on relative comparative advantages -Would leverage CMIM funds as IMF funds would also come in

To begin with, ASEAN+3 countries seeking financial resources should be required to apply simultaneously to both the IMF and CMIM and the IMF and AMRO should jointly analyse and evaluate the applications. Currently, the analysis and evaluation by the two institutions are separate with AMRO responsible for CMIM funds (AMRO, 2012). But AMRO's capacity is limited and it will take a long time to strengthen it. Involving both the IMF and AMRO in the analysis and evaluation process would increase its robustness in two ways. Firstly, experts from outside East Asia would support an understaffed AMRO, and would arguably be less politicised than CMIM members. Decisions on applications could therefore be made more rapidly and involving IMF staff who, at least in theory, should feel more dispassionate about the country requesting a CMIM package. A crisis triggering an application for CMIM funds would need a decision to be taken in the shortest period of time and with the smallest moral hazard possible. IMF and AMRO intervention in the decision-making process would help both,⁴ since the speediness of AMRO and the robustness and experience of the IMF would produce complementarities.

In addition, a joint application to both the IMF and CMIM would help address the IMF stigma in East Asia. Given the experience of the 1997 AFC, politically it would be very difficult to sell an IMF programme anywhere in East Asia (Robles, 2015). Having a joint process together with an ASEAN+3 institution – AMRO – would eliminate the potential duplication in terms of applications, while also lessening the political fallout of any

programme the IMF might want to impose. For the IMF, this would limit the potential for forum shopping that ASEAN+3 institutions have brought. It would also require institutional adaptation in the form of working jointly with regional institutions that the IMF has been willing to undertake in the case of Eurozone crisis-related bailout packages.

The second area of cooperation between ASEAN+3 and the IMF would be joint monitoring and surveillance, and conditionality. Given that the IMF and AMRO reports have the common goal of ensuring that signs of financial stress are caught well on time to prevent a possible crisis, it would make sense for the two institutions to combine their capabilities. AMRO, as already noted, has very few staff. But they all come from ASEAN+3 members, giving them familiarity with one or more countries in the region – including relevant language skills and cultural understanding (Sussangkarn, 2011). For its part, the IMF is better-resourced and has staff with knowledge about financial systems in different parts of the world (Clegg, 2013). Pulling their resources together through joint IMF-AMRO missions and analysis including conditionality would strengthen the surveillance mechanism. The two institutions should focus on their relative comparative advantages – the IMF on macro and micro financial and cross regional experience and the AMRO on regional financial and capital market developments and structural reforms.⁵ A division of labour is thus eminently feasible.

The third area of cooperation would be co-financing and joint supervision of liquidity provision programmes. Currently, financing would only come from the CMIM pool (AMRO, 2012), which, as already explained above, would probably be insufficient to avert the spread of a financial crisis. Co-financing with the IMF would substantially increase the resources available for ASEAN+3 to deal with a financial crisis. As the experience of joint EU-IMF programmes shows, the percentage of a total rescue package coming from the RFSN and the IMF can be negotiated on a case-by-case basis (European Stability Mechanism, 2016). Also, joint supervision of any approved liquidity provision programme would be the natural consequence of joint approval and financing. The institutional adaptation of the IMF to work hand-in-hand with EU institutions could be transposed to the East Asia region.

The timing is also appropriate for a more structured form of complementarity between the IMF and ASEAN+3 RFSN. Following the AFC, Asian countries had the IMF stigma which originated from the feeling of being unfairly treated and being forced to accept inappropriate conditions. This is now changing and the IMF is invited to ASEAN+3 surveillance meetings together with AMRO (ASEAN+3 Finance Ministers and Central Bank Governors, 2016). The IMF has also engaged in dialogues with AMRO as part of its outreach activities, although it does not have a formal technical assistance program (IMF, 2013). This engagement should be deepened further to a more structured form of ASEAN+3 RFSN and IMF cooperation as outlined above. The IMF should not reject such offers as it would be seen as being too euro-centric. A few years back, to reflect Western domination of the IMF, Subramanian (2010) argued that the IMF was not an international but a Euro-Atlantic Monetary Fund. Thanks to its ongoing joint initiatives with East Asian institutions, the IMF is addressing this criticism and preventing forum shopping towards its ASEAN+3 counterparts. In order to enhance functional cooperation among themselves, AMRO and the IMF are discussing the possibility of signing a memorandum of understanding (MOU) among themselves.⁶ Such a MOU should be comprehensive and cover all functional areas of cooperation identified above between the two institutions.

Beyond cooperation, “healthy” cooperation between the ASEAN+3 RFSN and the IMF is also desirable. As already mentioned, the ASEAN+3 RFSN has not been tested as yet. Co-financing between the IMF and the ASEAN+3 RFSN could substantially increase the resources available to manage a financial crisis. During the recent Eurozone crisis, two separate packages of \$142 billion and \$130 billion (in current dollars) were put together for Greece and \$100 billion for Portugal. Such large amounts of financing might not have been possible without the joint financing from the IMF and the European Stability Mechanism under the “troika” framework (Pacheco Pardo and Rana 2015).

In summary, East Asian countries do not take a competitive approach to relations with global institutions⁷. The ASEAN+3 RFSN might have been created due to unhappiness with the behaviour of the IMF during the AFC and replicate some of its functions, but the CMIM and AMRO have and should take a cooperative approach towards their relations with the multilateral institution. Functional complementarity and the still-limited capacity of regional institutions are the main reasons behind cooperation.

Limits to cooperation and “healthy” competition between ASEAN+3 RFSN and IMF

History poses a potential limit to cooperation and “healthy” competition between the ASEAN+3 RFSN and the IMF. The former was set up because of the displeasure with the behaviour of the latter by the same East Asian countries that blamed the Washington-based institution for exacerbating the AFC (Pacheco Pardo and Rana, 2015). In other words, regime creation in the form of the ASEAN+3 RFSN was the response in the region to the behaviour of the IMF during the crisis. No East Asian country has requested support from the IMF since the AFC – not even during the global financial crisis when several European countries did – suggesting that an underlying IMF stigma, although decreasing, remains in the region.

Rhetoric-reality gap could also limit cooperation between the ASEAN+3 RFSN and the IMF. Many of the announced safety nets have not been implemented effectively and utilized in times of crisis. For example, when Singapore and South Korea faced a financing constraint at the time of the global financial crisis, they triggered bilateral swap arrangements with the US Federal Reserve instead of activating the CMIM (Pacheco Pardo and Rana, 2015). Such rhetoric-reality gap could limit CMIM-IMF cooperation in the future.

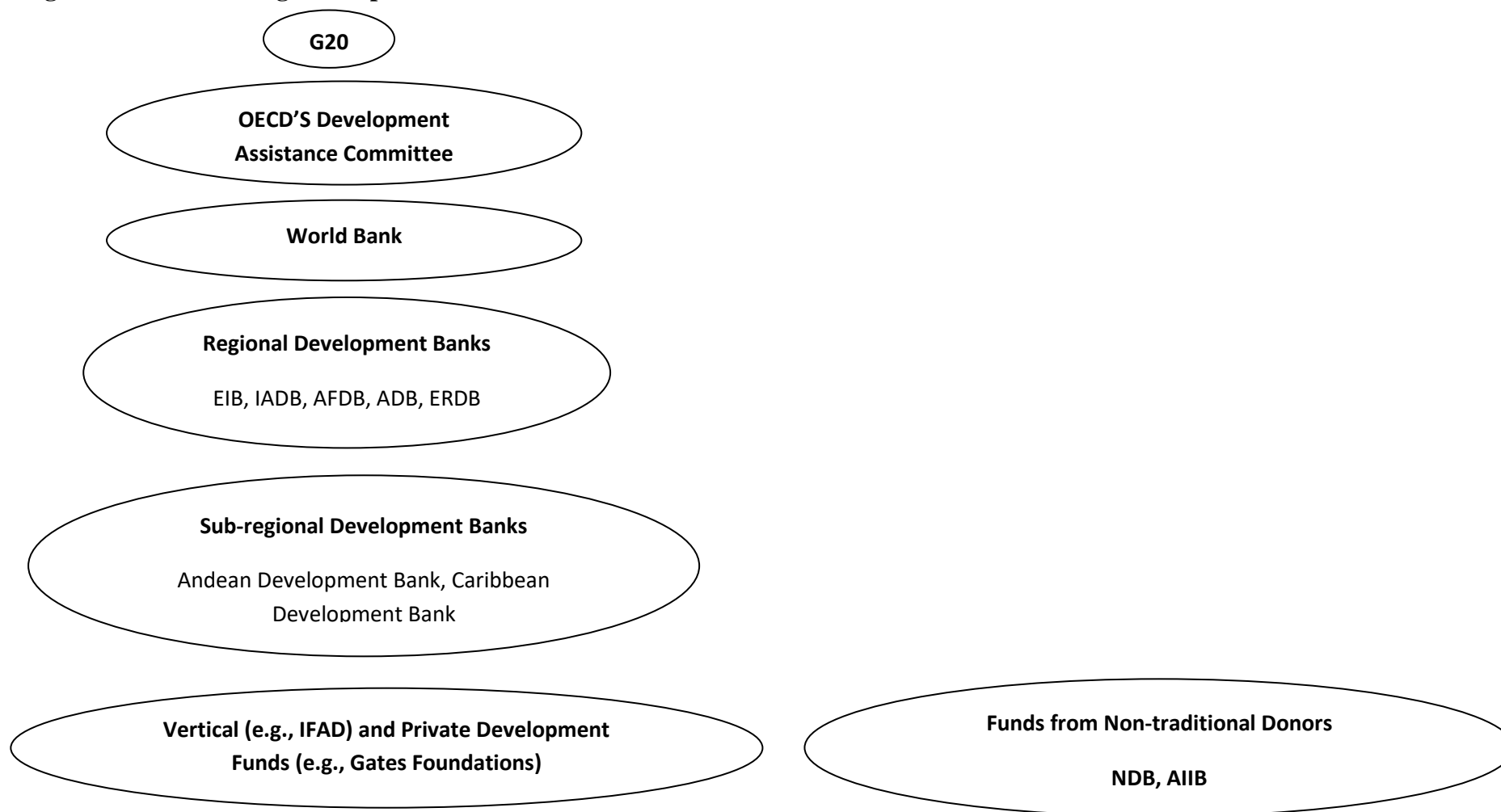
Geopolitical competition could also prevent ASEAN+3 RFSN-IMF cooperation. The US retains veto power over IMF decisions. It can also effectively reject nominations to head the institution, and is able to shape financing packages to countries outside of Europe (Weisbrot, 2015). Even in the case of recent EU bailout packages, the US helped to shape the IMF’s decision to offer debt relief to Athens, since Washington sought to maintain Greece in the Eurozone in spite of opposition from Germany and other EU member states (Weisbrot, 2015). American influence over the IMF could certainly derail crisis management cooperation with the CMIM.

Decentralising Development Finance Architecture

Over the past 70 years, the global development finance architecture has evolved dramatically. From one institution we now have a multitude of development banks and funds. These include multilateral development banks (MDBs), a variety of sub-regional banks, and a number of specialised vertical funds. A large number of private funds with a development focus have also emerged.

Five stages in the evolution of the global development finance architecture can be noted (Figure 3). The Bretton Woods conference established the World Bank in 1944 to finance post-war reconstruction. The second stage saw the establishment of regional development banks in the 1950s and 1960s, including the Asian Development Bank (ADB) in 1966. This was followed by the emergence of sub-regional development banks, mainly in Latin America. In the fourth stage, from the mid-1970s to the 2000s, specialised vertical funds – such as the International Fund for Agriculture Development – were established to address global issues, and private development finance – such as the Gates Foundation – expanded.

Figure 3: Decentralising Development Finance Architecture



Notes: ADB = Asian Development Bank; AFDB = African Development Bank; AIIB = Asian Infrastructure Investment Bank; EIB = European Investment Bank; ERDB = European Bank for Reconstruction and Development; IFAD: International Fund for Agricultural Development; NDB: New Development Bank.

The current fifth stage is closely related to the economic emergence of China, along with other BRICS or non-traditional donors. While traditional donors, namely the countries which are members of the Development Assistance Committee (DAC) of the OECD, are financially constrained and are concerned with conserving their resources, non-traditional donors are expanding their bilateral and multilateral assistance (Kragelund, 2011). In July 2014, China and the other BRICS formally agreed to launch the NDB, a new non-traditional MDB. Then, in October 2014, China announced the founding of the AIIB – another non-traditional MDB. Both institutions are already in operation and have signed their first few projects.

China and Non-traditional MDBs

Beijing has made clear that it sees the AIIB and NDB as complementary to existing MDBs (Xinhua, 2015a, 2015c). However, several others see them as a challenge. The AIIB, in particular, has proved to be very controversial. Wary of the potential for this institution to undermine its influence in Asia, the US was opposed to its launch and tried to stop allies from joining in (Beeson and Li, 2016). Japan also refused to become a founding member of the AIIB, which Tokyo sees as a threat to the role of the ADB (Mie, 2016). Geopolitical considerations are the main reason behind the position of the US and Japan. They believe that the AIIB, especially, can undermine their economic power in Asia (Ren, 2016).

Notwithstanding this apprehension, the two new MDBs led by China are required for several reasons. First, there is a massive need for infrastructure finance in Asia (Reisen, 2015; Weaver, 2015). Studies for the ADB indicate that there will be an investment need of \$8.2 trillion of infrastructure in developing Asia during 2011-2020 (Inderst, 2016). Until recently, the World Bank and the ADB were the two key MDBs providing development assistance to Asian countries. Traditionally the sectorial priorities and areas of operations of these traditional MDBs have been closely correlated with the prevailing development theory. In the 1960s and 1970s the prevailing development theory was the Harrod-Domar model which placed emphasis on the need to boost investment in order to achieve higher economic growth (Solow, 1994). Hence during this period, both MDBs focused on projects for infrastructure development together with projects in the agricultural sector and those to meet the basic needs of the population. In the 1980s, the Solow model became popular and the focus shifted to economic policy reforms and economic liberalisation policies (Solow, 1994). Operations of the MDBs, accordingly shifted away from projects to structural adjustment loans to support economic reforms and to promote the private sector. In the 1990s, the focus of development efforts shifted yet once again to country ownership to enhance aid effectiveness by building networks and interconnectedness (Killick, 1997). Hence during the decades of the 1980s and 1990s, developing countries in Asia were deprived of infrastructure projects from the World Bank and ADB.

Reflecting the above trends, MDBs currently account for only ten percent of global infrastructure provision (about \$40 billion in 2013) and their investment in infrastructure has declined considerably as a share of total investment in recent decades (Humphrey 2015). The share of infrastructure in total investment of the World Bank fell from about 70 percent in the 1960s to about 30 percent in the 2000s. The fall was less dramatic in the case of the ADB, from 55 percent in the 1960s to about 50 percent in the 1980s. At the same time, however, demand for infrastructure finance has increased greatly in Asia (Inderst, 2016). To address this situation, the AIIB and NDB have a clear focus on infrastructure building. This points towards functional fragmentation and functional needs being one of bases for the creation of new institutions.

Second, the governance structure at many MDBs – particularly at the World Bank – was designed as part of an economic and political order that no longer exists. The governance of the World Bank has not kept pace with the rising economic and political clout of China and other emerging powers (Reisen, 2015; Weaver, 2015). Even post-global financial crisis voting share reforms were insufficient to give Beijing the voice that it thinks it is entitled to. China has been critical of its underrepresentation in the World Bank and other international institutions (Humphrey 2015; Vestergaard and Wade, 2015). In this sense, the US-dominated World Bank and its inability to reform can be considered as an expression of Washington seeking to maintain the upper hand in its geopolitical competition with Beijing.

Issues confronting Non-traditional MDBS

Considering that the AIIB and NDB have been established due to the perceived inadequacies of existing MDBs, it is not surprising that they have raised a number of practical issues that China needs to address. These issues relate to the type of relationship that the new MDBs will have with their decades-old counterparts. First, there are questions about whether the world needs new MDBs. Former World Bank senior director Ravi Kanbur (2013) has argued that from a global perspective, it is inefficient “for new institutions to be created when the old ones could in principle be reformed to reflect new realities and new economic weights.” According to Beijing, reform of global institutions might have been the best option, but this has not happened (Weaver, 2015).

Second, the US Treasury – among others – has expressed its concern that the AIIB will fail to meet environmental standards, procurement requirements, and other safeguards applied by the World Bank and the ADB (Perlez, 2014). Thus, the AIIB could undermine existing practices agreed by other MDBs. This would challenge the norms currently underpinning development financing through the creation of new institutions. The Chinese government, however, has argued that the AIIB will comply with international standards (Zheng, 2015). This provides support to the idea that Chinese-led MDBs have been launched due to functional needs rather than displeasure with existing institutions only – namely, covering financing shortfalls and infrastructure gaps. These reassurances have probably been central to developed countries such as Australia, Germany and South Korea becoming founding members of the AIIB.

Third, China is not a member of the OECD Development Assistance Committee (DAC) that coordinates aid and tracks the flow of official development assistance (OECD, 2016a). China stresses that it is a developing country itself and therefore defines its support for developing countries as south-south cooperation rather than development assistance; it is willing to coordinate its aid provision, but only if coordination mechanisms are reformed (Xinhua, 2015b). Were this principle to be followed by the AIIB and NDB as well, new and older MDBs might end up implementing very similar projects in the same locations.

China’s argument regarding aid once again points towards the potential geopolitical tension between Beijing on the one hand and Washington and Tokyo on the other. Both the US and Japan are part of DAC and thus coordinate their aid, along with the other members of the committee. China, meanwhile, does not need to coordinate. Indeed, there is an ongoing competition between Beijing and Tokyo in their aid towards Southeast Asia (Pacheco Pardo, 2017). And yet, this competition can be mitigated by the potential functional complementarity between Chinese and Western aid, if each of them retains its respective current focus on infrastructure and social goals.

AIIB, NDB and “Healthy” Competition with Traditional MDBs

Considering the reasons why AIIB and NDB were set up and some practical issues regarding their operation, a key question is whether the AIIB and NDB should compete with or complement the World Bank and the ADB. A modicum of “healthy” competition would be beneficial for countries with a pipeline of infrastructure projects. The establishment of the AIIB and NDB has already started to trigger a funding race and an infrastructure investment boom. At the World Bank annual meeting in October 2015, the World Bank took initiatives to initiate a capital increase (Donnan, 2015). Earlier, in March 2015, it also launched a Global Infrastructure Facility in partnership with major development partners (World Bank, 2016a). The ADB has restructured its balance sheet and will increase its lending capacity from \$14 billion to \$20 billion by merging its Asian Development Fund lending with its ordinary capital resources (ADB, 2016). Both banks have signed agreements to jointly finance infrastructure projects with the AIIB (AIIB, 2016). The competitive situation could also encourage the established MDBs to streamline their operational procedures and enhance efficiency. In fact, there are signs of this happening in both the World Bank and the ADB. The G20 has also launched a Global Infrastructure Hub (Global Infrastructure Hub, 2016).

Potential for Cooperation between Traditional and Non-traditional MDBs

Beyond, “healthy” competition, both the World Bank and the ADB have shown their willingness to cooperate with the non-traditional MDBs. Beijing has reciprocated, aware of the complementarity among the different institutions in terms of functions. In order to identify possible areas for functional cooperation between the World Bank and the ADB on the one hand and the newly established MDBs on the other, in Table 2 we review the memorandum of understanding (MOU) that have been signed between the traditional and non-traditional MDBs. The agreements show that newly-launched MDBs, the World Bank and the ADB see potential for cooperation among themselves. Six broad areas of potential cooperation can be seen from the MOU signed by the World Bank and the ADB in 2001: mutual representation and/or staff secondments, consultation, knowledge and information sharing, operational procedures and practices, country specific, sector specific, and theme-wise operations, and funding/ co-financing arrangements.⁸ These are the areas included in the Table below. They show that there is functional overlap between new and pre-existing MDBs, which China can address by pressing the AIIB and NDB towards functional adaptation.

Table 2: World Bank and ADB Agreements with AIIB and NDB

Areas	WB-AIIB	WB-NDB	ADB-AIIB	ADB-NDB
Mutual Representation and/or Staff Secondment	----	Yes	Yes	Yes
Consultation	Yes	Yes	Yes	Yes
Knowledge and Information Sharing	Yes	Yes	Yes	Yes
Operational Procedures and Practices	----	----	----	----
Country Specific, Sector Specific and Firm-wise Operation	----	Yes	Yes	Yes
Funding/Co-financing Arrangement	Yes	Yes	Yes	Yes

Sources: Co-Financing Framework Agreement between Asian Infrastructure Investment Bank and International Bank for Reconstruction and Development and International Development Association; Memorandum of Understanding between International Bank for Reconstruction and Development, International Development Association, International Finance Corporation, Multilateral Investment Guarantee Agency and New Development Bank; Memorandum of Understanding for Strengthening cooperation between Asian Development Bank and Asian Infrastructure Investment Bank; Memorandum of Understanding between Asian Development Bank and New Development Bank on General Co-operation

Table 2 suggests that potential cooperation is strongest between the World Bank and NDB, and the ADB and both the AIIB and NDB, with five of the six areas included in the World Bank-ADB MOU also covered in these agreements. Cooperation in sharing “operational procedures and practices” is excluded in all four MOUs summarized in Table 2. “Mutual representation and/or staff secondment” and “country-specific, sector specific and firm-wise operation” is also missing in the WB-AIIB MOU. Since the traditional and non-traditional MDBs have common countries of operation in Asia, functional cooperation between them will eventually cover all six areas as they build up their capacity.⁹

Of particular note is co-financing operations between the traditional MDBs and the AIIB. Out of eight projects approved by the AIIB at the time of writing, two are co-financed with the World Bank, one with the ADB, and another one with both of them (AIIB, 2017).¹⁰ Complementarity in terms of functions and geographical focus underpins cooperation. The pooling of financial resources between the older MDBs and their younger counterparts shows that states are trying to maximize membership of multiple institutions. It also shows rapid institutional adaptation from the World Bank and the ADB by signing agreements allowing for this pooling only two years after the launch of the AIIB and NDB.

An area of particular importance is collaboration in knowledge and information sharing, as this will help to address the concerns raised in some quarters regarding transparency, governance, accountability, debt sustainability and environmental standards that will be adopted by the AIIB. It will also help build the capacity of AIIB staff, which would benefit from the expertise and experience of their World Bank and ADB counterparts. As already mentioned, as per Table 2, it seems that the AIIB will initially have wider links with the ADB than the World Bank. Nonetheless, the World Bank and the AIIB have already signalled their wish to cooperate beyond co-financing (World Bank, 2016b). In this sense, a division of labour between the AIIB on the one hand and the World Bank and ADB on the other could emerge.¹¹

In contrast with the AIIB, the NDB has equally strong frameworks for cooperation with both the World Bank and ADB spanning five different areas but they are yet to be put into practice. Indeed, none of the NDB projects launched at the time of writing involve the World Bank or the ADB. They are jointly financed or implemented with BRICS-country institutions or firms (NDB, 2017). This suggests that the AIIB has been more willing to embrace cooperation with traditional MDBs than the NDB.

The AIIB and NDB are likely to be under pressure to comply with DAC standards and practices. The two newly established MDBs should, therefore, seek to participate in DAC meetings even as observers – as several regional MDBs currently do (OECD, 2016b). China should also provide data on its official development assistance to the DAC. Likewise, China should also participate in the World Bank-IMF debt sustainability framework and other international debt monitoring mechanisms. This would be beneficial for Beijing by boosting trust on its development financing practices. It would also support capacity building of the non-traditional MDBs.

To summarise, China is pushing for cooperation between the newly-launched AIIB and NDB and traditional MDBs. Beijing has expressed its displeasure with the behaviour of these MDBs and, especially, with its underrepresentation in them. But functional complementarity among institutions and the need for capacity-building underpin a cooperative relationship hitherto.

AIIB, NDB and Limits to Cooperation and “Healthy” Competition with Traditional MDBs

Historically, the governance structure of the World Bank has not kept pace with the rising economic and political power of China and other emerging markets (Woods, 2006). This could be a constraint to smooth cooperation between the World Bank and the new MDBs.

Arguably, however, geopolitical competition could be the biggest impediment to cooperation and “healthy” competition between the AIIB and NDB on the one hand and the World Bank and ADB on the other. Most obviously, the US refused to join the AIIB and cannot be part of the NDB (Wong, 2016). Since the US retains veto power over World Bank decisions and continues to appoint its president (Vestergaard and Wade, 2015), it could decide to block meaningful cooperation with the AIIB and NDB – particularly joint programmes if it is unhappy with it.

Similarly, the ADB has traditionally been seen as a Japan- and US-dominated institution – one in which the president has invariably been a Japanese national. It is no secret that China and Japan are engaged in a race to build infrastructure across Southeast and South Asia (Pacheco Pardo, 2017). Geopolitical competition among these two Asian countries could prevent sustained cooperation between the ADB and the two newly-established development banks.

Conclusions

The centralised global financial architecture established at the Bretton Woods conference is decentralising and fragmenting with a number of new regional institutions being established. In Asia, we have the CMIM and AMRO in the area of financial safety net and the new non-traditional MDBs, namely the AIIB and NDB, in the area of economic development finance. What type of relations should these institutions have with the traditional institutions such as the IMF and the World Bank? While a modicum of “healthy” competition between global and regional institutions would be desirable, we have argued that regional and global institutions should not – and indeed, do not – engage in “unhealthy” competition such as a race to the bottom, or implement beggar thy neighbour policies. Global and regional institutions should cooperate with and complement each other. As the literature on global governance fragmentation posits, functional overlap can trigger a division of labour process leading to institutional adaptation and, ultimately, cooperation among institutions.

In the case of the financial safety net architecture, we have suggested that the present ad hoc cooperation between the ASEAN+3 institutions and IMF should be more structured and systematic. This is the approach taken in Europe, and there are instances of functional overlap in crisis management and prevention which can trigger deeper cooperation. Indeed, there is already cooperation between AMRO and the IMF in the area of crisis prevention. Similarly, in the case of the development finance architecture, we have established how traditional MDBs – i.e., the World Bank and the ADB – cooperate with each other and suggested ways through which traditional and new non-traditional MDBs can cooperate with and complement each other.

There are, of course, limits to cooperation and “healthy” competition between East Asian and China-led institutions on the one hand and their global counterparts on the other. After all, both East Asian countries in general and China in particular have created new regimes at least

in part due to displeasure with existing institutions. There is also rhetoric-reality gap regarding implementation of policies in East Asia. Geopolitical issues are also important.

Cooperation and “healthy” competition between global and regional institutions will be mutually beneficial for both. The IMF and traditional MDBs can provide knowledge and capacity building services which would be valuable to the newly established CMIM, AMRO, AIIB and NDB. Similarly, cooperation with the new institutions would provide the IMF and MDBs with access to a larger pool of resources for liquidity provision or infrastructure financing. East Asian countries and China have chosen this path of cooperation and “healthy” competition rather than “unhealthy” competition with global institutions. But there are limits to cooperation.

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² We should note that we do not analyse bilateral or national arrangements due to space constraints.

³ Interview with Bank of Japan official, Tokyo, 12 August 2013; Korea Ministry of Strategy and Finance official, Sejong City, 2 October 2013.

⁴ This point was also made to us by a high-ranked AMRO official, Singapore, 26 September 2013.

⁵ This point was also made to us by an AMRO official, Singapore, 26 September 2013.

⁶ Interview with IMF official, London, 2 February 2016.

⁷ A high-ranked AMRO official informed us that the AMRO and IMF were discussing a draft memorandum of understanding covering many of the points made above, Singapore, 11 April 2017

⁸ *Memorandum of Understanding between the Asian Development Bank, the IBRD and the IDA*, December 2001.

⁹ This point was made to us by several high-ranked World Bank officials in an interview in Washington, DC, 2 June 2017

¹⁰ In our interviews with World Bank and ADB staff, we were informed that in the future co-financing with non-traditional MDBs would be actively promoted as the capacity of the latter was strengthened.

¹¹ This point was made to us by a high-ranked US government official, London, 6 February 2015.

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Pradumna B. Rana is associate professor and coordinator of the International Political Economy Programme at the Centre for Multilateralism Studies of the S. Rajaratnam School of International Studies, Nanyang Technological University, Singapore. His research interests include regional integration in East Asia, South Asian economies, and global economic governance.

Ramon Pacheco Pardo is senior lecturer in International Relations at King's College London and the Korea Foundation-Free University of Brussels (KF-VUB) Korea Chair at the Institute for European Studies. His research interests include East Asia's international relations and political economy, EU-East Asia relations, and the political economy of finance and entrepreneurship.